What should insurers do today to prepare for tomorrow?

Asia-Pacific insurance outlook 2019
We are excited to share the latest edition of the EY insurance outlook series, covering the major trends, disruptions and innovations that are reshaping our industry. It’s an opportune time to take stock as insurers are investing more than ever to reshape their business models to take advantage of subtly different growth opportunities around the world.

For this year’s outlooks, we brought together EY industry and functional professionals, as well as the strategists and technologists, in highly interactive “think tank” sessions. These groups identified and rank-prioritized the most powerful and dynamic trends and issues that they see in their work across the industry every day. The opportunities to innovate and disrupt are driving both customer-facing transformation and back-office optimization.

The EY team is clearly energized by what’s possible for insurance – better ways of working, a clearer sense of purpose, more effective use of technology and the industry’s unique ability to promote financial wellness. We would be delighted to hear your thoughts on the following report and this intriguing and challenging moment in the insurance market.
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Rising incomes and expanding populations have benefited life insurers across the region. Non-life sectors have grown in line with GDP growth.

Asia-Pacific markets in general and China in particular will also influence the future of insurance because they are hotbeds of innovation. From product design to distribution to technology adoption — insurers in the region are experimenting widely and boldly to capitalize on near-term opportunities and drive the industry’s long-term evolution.

The growth outlook for insurance
While life insurers grew marginally in recent years, non-life insurers in the region grew in the high single digits. See figure 1

- The region’s life market grew 0.4% from 2012 to 2017, which was in line with growth in the rest of the world (0.2%). While emerging markets grew at a rapid rate, advanced markets saw a decline. This growth is attributable to strong bancassurance sales in key markets, rising incomes and increasing awareness of the need for and value of life products.
- Non-life’s relatively high growth was fueled by overall economic growth in key markets. Policy decisions and regulation enabled growth in specific lines of businesses, such as health, crop and auto.

Macroeconomic backdrop
The overall growth landscape for Asia-Pacific economies remains positive – thanks to strong fundamentals, such as a high share of working population and strong domestic demand. Economic growth will also be fueled by rising levels of wealth and domestic economic growth in emerging markets. The material differences across the region cannot be overlooked, however.

Major emerging markets see higher growth rates than developed markets (e.g., Japan, Australia, Korea). Weak domestic demand and rapidly aging populations temper the growth outlook in mature markets. But growth has slowed even in emerging markets and is unlikely to return to previous highs, due mainly to weaker exports and global trade tensions. See figure 2

The region’s overall economic growth – and thus the insurance industry’s outlook – will be shaped by:

- Rising protectionism and potential trade wars
- Weak equity market performance
- Weakness in local currencies vs. the US dollar
- Ongoing political uncertainty in some markets
- Commodity price fluctuations – particularly for crude oil

1 In this report, the Asia-Pacific region includes the ASEAN countries, greater China, Korea, Japan and Oceania.
Asia-Pacific insurance: The big picture

Figure 1: Insurance growth by region, CAGR, 2012-2017

- **Life**
  - Asia-Pacific: 0.4%
  - Rest of the world: 0.2%
- **Non-life**
  - Asia-Pacific: 8.0%
  - Rest of the world: 0.9%
- **Overall**
  - Asia-Pacific: 2.8%
  - Rest of the world: 0.6%

Source: Swiss Re

Figure 2: GDP growth, Asia-Pacific vs. global growth

<table>
<thead>
<tr>
<th>Region</th>
<th>2012-2017 actual</th>
<th>2018-2022 estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advanced Asia-Pacific</td>
<td>1.8%</td>
<td>1.5%</td>
</tr>
<tr>
<td>Emerging Asia-Pacific</td>
<td>6.7%</td>
<td>5.6%</td>
</tr>
<tr>
<td>Advanced economies</td>
<td>1.9%</td>
<td>1.7%</td>
</tr>
<tr>
<td>Emerging markets</td>
<td>4.1%</td>
<td>4.3%</td>
</tr>
</tbody>
</table>

Source: Oxford Economics

Note: Advanced Asia-Pacific includes Japan, Korea, Australia, New Zealand, Hong Kong and Singapore. Emerging Asia-Pacific includes mainland China, Malaysia, Thailand, Indonesia, Philippines and Vietnam.
The state of the Asia-Pacific life insurance market
Overview and key trends

The Asia-Pacific life insurance market has delivered stronger growth than the global market, which has experienced weakness for years (see sidebar). While this difference obscures material differences in the region, a positive economic environment and a high propensity to saving in several countries have enabled growth. Life insurers should be cautious, however, and not assume these trends will continue indefinitely.

To sustain growth and unlock further opportunities, life insurers should focus on:
1. Linking regulatory compliance and business transformation
2. Analyzing demographic shifts to reassess strategic priorities
3. Elevating the cost management approach from tactical to strategic
4. Retaining the best of their traditional distribution channels, while wholeheartedly embracing digital

Those life insurers that master the mix of these initiatives will enjoy healthy growth, while preparing themselves for the future challenges as the region’s life insurance market matures.

Slow growth, weak performance

Annual gross written premiums, 2012-2017

Asia-Pacific 0.4%  China 17.6%  Japan -10.1%

Average expense ratios in top three Asia-Pacific markets

2012 28.0%  2017 30.2%

Source: S&P, Swiss Re, GlobalData
Over the last decade, the region's regulators have evolved their role. Once they were solely focused on enabling growth; today, they serve also as protectors of long-term sustainability and customer centricity. Consequently, the life insurance sector saw a wave of changes around capital adequacy, product designs and distribution quality.

Compliance costs have risen sharply, both in terms of expenses and management attention. Solvency regulations and the desire for high-quality underwriting will materially limit the growth in the region. However, these developments also offer opportunities to streamline operations and increase efficiencies. The merging – or at least stronger alignment – of regulatory compliance and business transformation programs is the best way for insurers to convert regulatory necessities into business value.

Linking regulatory compliance and business transformation
Demographic shifts:
The heart of strategic decision-making

Some large markets have huge numbers of young citizens. Others are challenged by their aging populations. However, shrinking population growth is common across all markets. See figure 3.

To meet the needs of a range of customer segments across the region’s diverse markets, insurers’ product portfolios must incorporate both:

- Wealth accumulation and retirement planning in underpenetrated developing markets
- Wealth management and retirement income in the developed markets

The appetite for life insurance products remains strong in emerging markets. The shifting demographics require a holistic distribution approach, with different channels designed to connect with multiple segments, though still offering a consistent purchase experience.

The low insurance penetration in these countries represents a win-win for insurers. Consider how the rise of bancassurance as a channel didn’t come at the expense of agents, but helped grow the overall market. Insurers should seek a similar outcome with digital distribution models, creating a virtuous circle of growth for the whole sector, rather than pitting one channel’s sales against another’s.

In contrast, insurers in developed markets with high life insurance penetration must prepare for a different shift. For example, banks in Japan are expected to halve their balance sheets in the coming decades and large numbers of insurance agents will retire without being replaced. To mitigate the risk that policyholders will be abandoned, insurers must develop digital offerings and experiences that work for older generations – potentially through a different entity. They must still seek new business for a declining share of relatively young people, too.

In both scenarios, it’s critical that insurers enhance the buying experience, increase overall engagement and customize the value proposition through more effective use of analytics and other enabling technologies.

Figure 3: Share of population > 65 years

Source: World Bank
Cost management: From tactical to strategic

In several Asia-Pacific markets, particularly the developing ones, insurers that reach a certain level of maturity are shifting their focus from a single-minded pursuit of growth to establishing cost efficiencies across the business. With maturity comes an increasing focus on cost efficiency. In their single-minded quest for growth and market share, and amid rapidly evolving regulations and product designs, most insurers are constrained by a mix of legacy systems. Hampering efficiency, these systems remain a huge cost disadvantage, as witnessed by high cost ratios, which continue to deteriorate across the region. See figure 4

For many insurers, large-scale transformation programs (particularly in back-office operations) and the adoption of integrated digital platforms are the answer to this cost conundrum. Such platforms enable insurers to put the customer at the center of their business and more effectively engage with a complex ecosystem of specialized partners, including InsurTechs. The additional complexity of the region comes from the critical importance of agents and bancassurance partners. Thus, any successful platform will need to create benefits and efficiencies for these distribution channels rather than focusing exclusively on digital.

In terms of digital transformation, some insurers in the region have proactively sought to manage costs by streamlining operations. Going forward, the focus will shift toward enhancing reach through digital platforms, leveraging AI to improve acquisition costs, and partnering with technology and niche players to gain further efficiencies.

Figure 4: Cost ratio trends, life insurance

Source: GlobalData
Distribution: Retaining the best of traditional and embracing digital wholeheartedly

That distribution is up for a major overhaul is not lost on life insurers. Agencies and, more recently, bancassurance have been the traditional channels for life insurance growth. However, rapidly evolving customer behaviors and digitization of customer access have led several insurers to go digital at a much faster pace than in other regions. See figure 5. The most prominent efforts include Ping An and other Chinese insurers that are actively working toward direct integrations with technology platforms to ensure strong reach.

However, traditional channels will continue to drive a major portion of life insurance sales in the years to come, commanding strong customer connections and dictating the margins for the overall business.

Thus, insurers must work on enhancing the ability of traditional distributors to address the needs of emerging customer segments. Digitally enabling or digitizing agency and bancassurance channels and integrating them efficiently with the rest of the business are imperative. The winners will be those insurers that offer the ability to seamlessly move from the transparency of online experiences to the context of personal, offline distribution. The integration of health products in the life insurance ecosystem also points to the need to master the distribution mix.

The bottom line: insurers should embrace digital, but also need to create benefits and efficiencies for traditional agency and bancassurance channels. These channels must be digitally enabled, rather than completely taken over by direct digital channels.

Figure 5: Share of digital life insurance sales, China

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>3.5%</td>
</tr>
<tr>
<td>2017 January-June</td>
<td>9.0%</td>
</tr>
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</table>

Source: IAC
**Imperative actions:**
**What life insurers should do next**

Despite challenges, the Asia-Pacific region offers massive growth potential across most markets. That some life insurers are boldly pursuing innovation also bodes well. To make the most of the opportunities, life insurers must:

1. Focus on one regulatory change (e.g., IFRS 17, Risk-based Capital, C-ROSS) and align implementation plans with a business transformation initiative to drive value beyond regulatory compliance and then scale up this approach.

2. Develop a new distribution and servicing strategy for a particular customer segment, based on the general trend toward digital and away from traditional channels.

3. Benchmark cost ratios against global peers to identify best practices and elevate the cost optimization agenda.
Revisiting key lines of businesses and expanding new opportunities

Non-life insurance markets in the Asia-Pacific region have enjoyed very healthy growth, largely sustained by emerging market performance (see sidebar). While growth will inevitably slow down, considerable opportunities remain, especially in those areas where the region’s insurers are aggressively experimenting and innovating.

To maintain growth, improve margins and prepare for future disruption, non-life insurers should focus on:

1. Evaluating opportunities in health insurance
2. Exploring intangible risks to boost commercial insurance
3. Following China’s lead on digital distribution
4. Raising the digital bar by deploying analytics and AI

The ability to carefully select new market niches and to innovate digitally on both the customer-facing front-end and in the back-office will determine tomorrow’s winners.

Strong growth, mixed cost performance

<table>
<thead>
<tr>
<th>Region</th>
<th>Annual gross written premiums (non-life, 2012-2017)</th>
<th>Expense ratios</th>
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<tbody>
<tr>
<td>Asia-Pacific</td>
<td>8.0%</td>
<td>16.5%</td>
</tr>
<tr>
<td>China</td>
<td>16.5%</td>
<td>2012-2017</td>
</tr>
<tr>
<td>South Korea</td>
<td>-2.4%</td>
<td>12%</td>
</tr>
<tr>
<td>Japan</td>
<td>30%</td>
<td>18%</td>
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</table>

Source: Swiss Re, GlobalData
Health insurance: The torchbearer of growth

Health insurance has been expanding rapidly in several markets. See figure 6. The following factors point to continued growth:

- Coverage gaps: State coverage in most markets is highly inadequate or is being phased out gradually to reduce financial burden on governments.

- Rising health cost inflation: Health expenses have been growing faster than incomes, leaving a huge gap for individuals and institutions to cover.

- Aging population: In several large markets, the share of elderly population is rising. Lifestyle-related diseases also increase the need for health coverage.

However, to accurately and profitably underwrite health insurance, insurers must gain a clearer understanding of customer health risks. That requires new data sets and the application of big data analytics.

At the same time, health insurers will get a strong push from the development of private healthcare ecosystems. Historically, insurers have looked to buy hospitals and other assets in building these ecosystems. In the future, they will position themselves at the center of ecosystems to promote better customer experiences and value propositions more relevant to customers.

Figure 6: Health insurance premium growth, CAGR, 2012-2017 (USD)

<table>
<thead>
<tr>
<th>Country</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>39%</td>
</tr>
<tr>
<td>Thailand</td>
<td>10%</td>
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</table>

Source: GlobalData
Commercial insurance: Intangible risks gain attention

Commercial insurance has not generated much volume in the region — particularly in emerging markets. However, intangible risks — such as those around intellectual property (IP), cyber and reputation — are becoming increasingly important and attracting more attention. Cyber insurance, for example, is gaining traction in the market. See figure 7

Figure 7: Growth in cyber insurance, 2015-2025

Despite not fully understanding these risks or knowing how to assess them accurately, insurers still feel compelled to offer these products. Indeed, many industry stakeholders and institutional customers believe that intangible risks are uninsurable. However, ongoing technology change necessitates that insurers figure out how to offer proper coverage. Consider how more businesses will soon rely heavily on robotics; if insurers want to remain relevant, they need to find a way to cover potential losses for these businesses.

The challenges include:

- Limited natural pull in several developing markets
- The lack of reliable information and historical data to underwrite intangible risks
- The industry perception that these risks are uninsurable

Insurers that want to be relevant in commercial insurance must lead the way forward. The winners will be those that get the basics right by:

- Gaining access to relevant and real-time data sources around key intangible risks
- Partnering with specialized firms with expertise in specific categories of risk
- Clearly communicating to potential clients the value proposition, including what’s at stake and how insurers can help

Source: EY estimate
Digital distribution: Following China’s lead

Major disruption has already occurred in certain lines of businesses in certain markets, such as property insurance in China. See figure 8 While traditional channels still contribute the majority of P&C volumes, the following factors will drive greater online penetration:

- Development of new platforms by technology and ecommerce leaders: Integrated digital platforms and applications (such as WeChat) providing a one-stop source to easily purchase insurance and many other products have made significant gains in China. They are gradually taking hold in other markets.
- Greater transparency: Aggregators allow P&C customers to easily compare prices and features before purchasing policies.
- Raising customer expectations: Consumers are less willing to go through insurers’ antiquated sales processes, thanks to the seamless and personalized experiences they have with businesses in other sectors.

Both insurers and third-party distributors must innovate in approaching customers and selling insurance. The goals should be to improve cost efficiency, reduce time to market and provide a superior customer experience on a truly transparent digital platform. That will require insurers to develop technological and operational agility.

Figure 8: Share of top four online-only property insurers, China

![Source: Xinhua](image-url)
Analytics and AI: Raising the digital bar

Discussions of “digital” in insurance are usually primarily around distribution. Asia-Pacific P&C insurers – particularly in developed markets – increasingly consider digital across the entire value chain. Beyond distribution, digital offers upside in claims management, finance and many other back-office functions. The ultimate goal is a more efficient organization and a better user experience, which requires insurers to get more data and use it more effectively.

Consider how insurers with the right data infrastructure can use AI and blockchain to offer cost-efficient products which provide real-time coverage and instant claim settlements. These models are already taking hold:

- Chubb recently launched an app-based flight delay insurance product in Australia.
- Using apps, extensive historical data and automation, Ping An aims to settle 90% of auto claims in a matter of minutes without any manual intervention in the near future.1

The massive amount of data available from connected devices provides insurers the means to achieve unprecedented levels of accuracy in underwriting and rating risks – but only if they can use this data effectively. For many insurers, that’s a big if.

To reap the benefits, insurers must evolve their mindsets and cultures so that they are truly data-driven. Evidence-based decision-making must be the norm with a strong, AI-powered and analytics-enabled data architecture serving as a foundation.

Many insurers have started by building data warehouses or other repositories without a clear view on how to use the data. Some seem to be merely demonstrating their activity in the data space.

It’s necessary to build the data infrastructure and simultaneously get the business on board. Insurers must commit to experimenting in areas that are relevant to their individual strategies and where they can move the needle on competitive advantage.

Those insurers that get it right will be able to reduce costs, streamline operations and take advantage of predictive analytics. The end results – such as personalized conversational experiences and hassle-free service – will deliver both cost efficiencies and genuine differentiation.

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1 Forbes: “Ping An Looks Beyond Insurance To A Fintech Future”
Imperative actions: What non-life insurers should do next

To sustain the strong growth of recent years and navigate the likely prolonged economic slowdown, insurers must:

1. Test which parts of the health business are ready for outcome-based plans and find ecosystem partners to roll out such offerings.

2. Select one intangible risk to explore and start modeling it with at least one new data set and in collaboration with a specialized firm.

3. Revisit your distribution strategy to account for declining channels, different customer segments and the shift to digital.

4. Target a specific process on which to apply advanced analytics using existing data repositories.
China insurance outlook: Maintaining status as the “world’s growth engine”

Though growth has stagnated in the global insurance market, China has singlehandedly driven the growth of the entire sector in the last decade, rising from the seventh-largest national market to the second-largest in that time. See figure 9. Strong economic and bancassurance growth, high government spending, increased consumer awareness and innovation in product design have all contributed to this dramatic growth.

Despite challenges regarding profitability, issues around treating customers fairly, competition from new market entrants and regulatory activism to promote sustainability, the outlook remains strong.

Sector convergence: Creating opportunities and increasing competition

Cross-sector convergence is in full swing in China. Insurers are expanding both upstream and downstream along the value chain, and tech players are making inroads into insurance.

Some health insurers (e.g., Sunshine Insurance Group) have established hospitals or acquired a hospital chain (e.g., New China Life). Pension-focused players have expanded into real estate such as old-age homes (e.g., Taikang Life). Some insurers are experimenting internally while others are leveraging alliances. The objective is to diversify revenue streams and enhance margins by offering customers greater value and engagement.

Figure 9: Growth of insurance gross premiums, 2012-2017

<table>
<thead>
<tr>
<th></th>
<th>Life</th>
<th>Non-life</th>
<th>Absolute premium growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>17.6%</td>
<td>16.5%</td>
<td>$296b</td>
</tr>
<tr>
<td>Rest of the world</td>
<td>-1.2%</td>
<td>1.3%</td>
<td>-$17b</td>
</tr>
</tbody>
</table>

Source: Swiss Re
At the same time, technology and ecommerce players are aggressively setting up platforms to offer insurance as an allied product, often with simple yet innovative twists, such as the recent mutual insurance product on Alibaba’s platform. These new offerings have the potential to reshape the product landscape, as well as the way insurance is sold and distributed.

While these developments currently contribute only a small share of premiums, the disruption is here to stay. In such an environment, insurers will have to proceed cautiously with innovative investments to ensure that core businesses’ profitability and sustainability are not impacted.

**Customer service: The advantages of being technology-led**

While insurance technology in China is already among the best in the world, the ability to provide differentiated service varies across insurers. Some of the biggest insurers – particularly Ping An – already leverage AI and analytical capabilities to offer exceptional client service. Using big data analytics and AI, insurers have started to build multivariate models to predict risk and rating. Eventually, those technologies will be used for underwriting and claims handling – particularly in some of the largest business lines, such as auto. For the most advanced insurers, everything from issuance to claims handling is processed over the cloud with little to no manual intervention.

While tariff restrictions have limited innovations to some extent, technology-enabled service is allowing insurers to win market share and will shape the sector’s future. While larger players have gained market share from digital transformation, small and medium-sized players still lag behind. For smaller insurers, accessing the latest technologies to boost capabilities in underwriting, claims handling and client servicing will be more difficult. Forming partnerships with innovative InsurTech firms will be critical.

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**Technology firms to play a major role in insurance in China**

>8 billion by end of 2017

Number of policies sold by online-only insurer Zhong An (jointly launched by Ping An, Tencent and Alibaba in 2013) through tie-ups with ecommerce and other platforms

*Source: Reuters*

>US $120b by 2022

*Source: EY analysis*

Through a recent acquisition, Alibaba offers mutual insurance with no premiums to be paid upfront. While a number of mutual insurers have failed to make a mark in China in recent years, Alibaba has the advantage of both massive scale and access to the right technology. Within a few days of launch, several million customers signed up on the platform.

*Source: China News Service*
Life: Regulation to drive product and distribution mix

Much of life insurance’s growth in the last decade came from investment-linked products sold through banks, with most customers usually buying life insurance more as a banking product than as insurance. See figure 10. However, with increasing focus on protection-oriented products such as whole life and endowments, the regulator has asked insurers to shift their focus toward traditional products. Insurers, therefore, will need to transform their product, distribution and management structures.

The role of agents will remain important in supporting traditional life products. Agencies remain an expensive channel, meaning digital channels will continue to grow. In this environment, insurers – particularly small and medium players – must look at digital models to distribute insurance and possibly leverage the new platforms being set up by tech companies such as Alibaba and Tencent.

P&C: Policy pressure to push affordability and growth

With a rapidly aging population, social security has the potential to become a significant burden for the government. That’s pushing P&C insurers to offer more affordable products. On the personal side, health is expected to be the fastest growing segment, as medical inflation remains high. On the commercial front, demand has typically been policy-driven as businesses are compelled to buy insurance from a compliance perspective.

Two new areas that may see significant growth in the future will be workplace compensation insurance and liability insurance, which may become compulsory as recently indicated by the central government. Cyber insurance will also see strong demand, with the central government recently issuing strict data privacy norms.

Consolidation: Driven by high interest from foreign players

Regulators have recently relaxed shareholding norms for foreign insurers (initially to 50%, to be increased to 100% by 2022). While foreign insurers have not had a significant impact on the domestic market to date, a rise in foreign capital investments in the near future will change the market dynamics.

Additionally, as the regulator’s time to approve new licenses has gone up sharply in recent years, acquisition looks to be an efficient way to enter or expand in the market, particularly where owners are willing to exit unprofitable operations.
Japan: Transformation imminent as growth remains elusive

Despite a material decline in recent years, Japan's insurance market remains among the top three globally. See figure 11
The country faces challenges which, while unique, present a view of what the future might look like for the rest of the developed world. Stagnant economic growth, a declining and rapidly aging population and sharp deterioration of net household savings have all reduced demand for insurance.

Despite the overall woes, both life and non-life insurers in Japan have shown great adaptability in maintaining profitability.

Life: Product design adaptability key to sustainability

Despite sustained low interest rates, Japanese life insurers have displayed commendable product mix flexibility over the years. For instance, sales of low-margin, yen-denominated, single-premium savings products have been curtailed since fiscal year 2015, with increasing focus on USD-denominated products and medical and disability protection product sales. See figure 12

Pursuing longevity-focused products will be critical to meet the demands of Japan's aging population. However, high life insurance penetration, coupled with high rates of penetration in long-term care products, means insurers must present a comprehensive value proposition. That includes offering attractive returns despite low interest rates. A greater share of products denominated in US dollars can help deliver such returns, an approach adopted by a number of life insurers in recent years. See figure 13

IT and cost transformation: Essential undertakings

In mature markets like Japan’s, insurers have massive books of business with decades-old policies administered on legacy IT systems. This makes effective data use a challenge and policy management very expensive. Additionally, with low interest rates leading to weak investment results, controlling expenses will be the prime lever to sustain margins. Those costs have risen in recent years. See figure 14

Since Japan is a very traditional market, there are significant opportunities to improve overall cost structures – particularly on the non-life side. While some insurers have already taken steps to enhance specific value chain elements, more needs to be done. Implementing the latest claims administration and policy management platforms, in conjunction with robotics process automation and blockchain, will go a long way to increasing efficiency. Without such changes, insurers risk exposing themselves to further cost escalations, higher cyber security risks and poor customer service.
Figure 11: Growth in insurance gross premiums in Japan, 2012-2017 (in USD)

- Life: Japan (2.6%) vs. Rest of the world (-2.4%)
- Non-life: Japan (2.3%) vs. Rest of the world (-10.1%)

Source: Swiss Re

Figure 12: Annualized net premium growth in newly acquired third-sector policies at top-seven rated life insurers, FY13-FY17

- Life: Japan (7.1%)

Source: Moody’s

Figure 13: Japanese life insurers’ asset allocations to foreign bonds

- Life: FY13 (18%) vs. FY17 (24%)
- Non-life: FY12 (11.4%) vs. FY17 (13.4%)

Source: Moody’s

Source: Life Insurance Association of Japan
**Shifting traditional distribution to digital**

Reflecting the broader aging population, the distribution workforce – both captive and independent agents – is retiring without adequate replacements. See Figure 15. Additionally, bank branch networks are expected to shrink in the coming years leading to a reduced share of business from bancassurance. Over the decades, agent and banking channels have been critical in affecting product mix changes, managing customer relationships and keeping insurers resilient in times of low growth.

Consequently, to replace existing distribution strength, insurers have to shift more business to digital channels. Increasingly tech-savvy customers will support the transition. Insurers must ensure that the digital interfaces and the products sold online are easy to understand and intuitive to manage.

In this context, insurers need to experiment with lean omni-channel offerings supplemented by cross-sector channel convergence. Such experiments leverage the unique nature of Japan’s interlocked conglomerates (keiretsu) and their ability to serve existing customer groups and contest new market niches with partners from other industries.

**200**

Estimated reduction in bank branches by two major Japanese banks (Mizuho, MUFG) on account of digitization, representing roughly 20% of their combined networks.

*Source: Company presentations*

**Auto: Ongoing profitability, but uncertainty from telematics**

So far, leading Japanese non-life insurers have displayed limited appetite toward adopting new technologies. The auto-led domestic market remains profitable, with claims ratios improving sharply in recent years. See Figure 16. Favorable margins have been supported by a series of rate increases over the years and the continued dominance of the top three non-life insurers, which control auto insurance prices.

However, the use of telematics-based technologies by new players – particularly in pay-as-you-drive products – will reduce rates for customers with favorable driving behaviors. That scenario may elicit a response from the incumbents, as InsurTechs with strong big data and machine learning capabilities may succeed in gaining market share. Thus, leading insurers must embrace the promise of telematics, and explore the best ways to leverage and supplement existing data sets to deliver a compelling experience at par with, or even better than, what new entrants may propose.

**M&A: Limited domestic opportunities put focus on outbound**

Despite being the third-largest market globally, Japan has far fewer insurers than comparable, and even significantly smaller, markets. While market leaders dominate, several smaller players benefit from a captive customer base (e.g., cooperatives, unions). However, as the isolation of captive bases may not hold in the future, some smaller players may see consolidation as an appealing option over the medium and long terms. In the meantime, most large insurers have huge asset bases likely to be used for further outbound M&A, continuing the trend of recent years.

With low capital returns in the domestic market, insurers will continue to look for markets promising high growth and profitability in the future. For example, multiple Japanese insurers have shown interest in the Myanmar insurance market, which recently opened for foreign investments.
Figure 15: Absolute decline in number of corporate, individual and tied agencies in Japan since 2009

-10%

Source: Life Insurance Association of Japan

Figure 16: Net claims to net premium ratio for auto (voluntary and compulsory)

70% 2011
57% 2017

Source: General Insurance Association of Japan
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